Senate Budget & Taxation Committee

January 24, 2006

Testimony of Thomas K. Lee, Executive Director

Chairman Currie and members of the committee, good afternoon. Thank you for the opportunity to present and discuss the Maryland State Retirement Agency's proposed budget for fiscal year 2007.

As you know the State Retirement Agency carries out two equally important business functions – the administration of member and retiree benefits, and the management of invested assets. The continued success of these two core processes are of critical importance to the more 288,000 active and retired state and local participating employees, teachers, police, judges, law enforcement officers, correctional officers and legislators. Before addressing the analyst's recommendations, I would like to briefly update the Committee on the Agency's activities over the past year and the progress we have made.

Our emphasis continues to be on Agency infrastructure and policy. The annual update of our business plan, as required by the Board's new governance policies, ensures our focus is on our core processes and monitors our progress.

In July, the Board's specially appointed Corridor Funding Committee completed its review and reported on its findings and recommendations to the Board. The committee was established to review the corridor funding method and to determine an appropriate and acceptable funding strategy for the System. You may recall that the corridor method was established for the Teachers Combined System and the State portion of the Employees Combined System during the 2001 legislative session after several favorable years of investment returns which had reduced contribution rates.

The committee was charged with reviewing the implications of the corridor funding methodology in relation to the System's current funding situation; identifying any shortcomings with the existing methodology and recommend changes; and formulating a strategy for implementation of adopted recommendations. As part of the process, Milliman, the System's actuary, established a dynamic model for the Committee to project current funding into the future, while altering various assumptions (investment returns, smoothing techniques, different corridors, payroll growth, etc.).

In reviewing the alternatives the Committee members discussed many issues including the appropriate funding level and the desired timeframe to achieve this funding level given resource constraints and competing initiatives at the

State level. Ultimately, the Committee recommended, and the Board approved, an immediate transition to full actuarial funding.

Investment Management Activities

The State Retirement and Pension System portfolio returned 9.5% for the fiscal year ended June 30, 2005. The main determinant of this performance was our strategic asset allocation. This follows a 16.2% return for fiscal year 2004.

For the year, our diversifying asset classes such as real estate (27.5%), private equity (20.9%), and international equities (14.0%) all had double digit returns, while domestic equities (6.9%) and fixed income (7.8%) had more modest results. Our tactical asset allocation program, which began in 2004, also added $25 million of value during the year.

For the fiscal year ended June 30, 2005, our TUCs ranking was 61st percentile. The major detractor was the performance of our active external managers. Despite the performance of our active managers, we have still achieved median performance over the past two fiscal years, a vast improvement from the bottom quartile results in each of the previous three fiscal years. The Board has recognized the poor results from active management, and has made several changes to our stable of active managers.

Recent TUCs results have resulted in improvement in our intermediate term peer rankings, with the three year ranking now at the 58th percentile. While 2004 and 2005 numbers are encouraging, our five and ten year rankings remain at or near bottom decile versus peers. Improving the longer term rankings will require time, resources, and consistent application of a disciplined investment process.

For the fiscal year, the market value of System assets increased by $1.9 billion, from $30.2 billion to $32.1 billion. Over the past two years, assets have increased by $5.4 billion, even though the fund has been in a negative cash flow position with benefits paid exceeding contributions to the plan.

Despite the strong 9.5% investment return which once again exceeded the actuarially assumed rate of 7.75%, the funded ratio for the plan declined from 92% to 88%. This was in line with the expectations we've previously communicated, and again is due to the lagged effects of the market downturn of 2000-2002 and the resulting large gap that remains between the actuarial value of assets and the market value of assets. As we've mentioned in the

past, this downward pressure on the funded ratio could continue for several years even with strong investment returns, until the prior investment losses are fully realized.

During 2005, staff responsibilities have continued to increase, due to Board policies and initiatives. These policies have put in place much of the infrastructure for the fund as currently administered, and have expanded staff responsibilities in areas such as Corporate Governance, Risk Management, Emerging Managers, Compliance, Private Equity, Tactical Asset Allocation, Actuarial analysis, and the Optional Retirement Program. Over this same period, we have experienced continued staff turnover, and have found hiring and retention difficult due to our compensation scale in relation to the competitive environment for investment talent. The Board has endorsed a compensation study and limited salary setting authority to help address this issue.

We would stress the importance of viewing the pension fund as a revenue generator, rather than as a cost center. Given that adding one basis point of performance to the fund means generating over $3 million for the pension fund, incremental investment in people and technology that increases returns appears to provide an attractive benefit for the cost.

We are pleased that the SRPS has been able to deliver returns for fiscal year 2005 once again above the assumed rate of return. While we realize markets are cyclical and returns will not always be at 2005 levels, you can be assured we will continue to strive for competitive returns going forward in a challenging market environment.

Modernizing Legacy Technology and Disaster Recovery

The Agency continues to seek solutions to replace the outdated Legacy Pension System (LPS) that supports our benefit administration activities. Following the Maryland Systems Development Life Cycle (SDLC), in FY2005 the Agency performed system concept development activities to analyze the business problems associated with the LPS and identify and evaluate solution alternatives. As a result of that process, the Agency has selected a project approach to modernize the LPS.

There are two critical issues that are driving the need for the LPS modernization:

1. The LPS is too cumbersome. Because the LPS is constructed from outdated technologies, it cannot be adapted quickly enough to keep up to changes needed to implement retirement system plan changes and to meet the customer service expectations of the system members and retirees.
2. The LPS is too risky. Because the LPS is poorly documented and overly complex, making changes to it over time becomes increasingly risky. There is also growing risk associated with retaining qualified staff and contractors to maintain and enhance the LPS.

The Agency has developed a strategy that immediately addresses these two critical issues, but also provides a foundation to address other important issues (e.g., business process improvement, customer service) in the future. The Agency plans to develop the Maryland Pension Administration System (MPAS) to replace the LPS. The MPAS will be developed incrementally to allow the Agency to focus on the two critical issues; to reduce the risks associated with attempting IT projects that are too large, complex, and ambitious; and to validate that the MPAS is performing properly in parallel with the LPS. Implementing the complete vision for MPAS will be a multi-project, multi-year effort. SRA has identified the first two steps needed to implement the MPAS vision.

The first project is MPAS-1, Modernizing Legacy Technology. MPAS-1 has two goals:

1. Establish a new technology foundation for MPAS based on modern technologies to provide the agility needed to adapt to changing requirements.
2. Create MPAS by recreating the existing capabilities of the LPS on the new technology foundation.

This approach will allow the Agency to rapidly implement a new technology solution (by the end of FY2008) that is capable of adapting to changing needs and be the foundation for the complete MPAS vision. The scope of the MPAS-1 Project has intentionally been minimized to increase the probability of success. This does mean, however, that some limitations of the LPS will not be addressed until future MPAS projects, such as improving data quality, providing online services for members, and improving business processes. The process to acquire the services needed to accomplish MPAS-1 is underway.

The MPAS-2 Project will be launched to address the next highest priority when SRA is certain of the success of MPAS-1. The objective of MPAS-2 is to improve the quality of MPAS data by:

1. Improving the system controls that edit data coming into MPAS,
2. "Cleaning" the data already within MPAS, and
3. Improving the business processes and systems used to collect payroll data from employers.

SRA has implemented the Project Management Office (PMO) and project governance procedures to ensure that these mission critical initiatives are effectively monitored and managed.

The Agency recognizes that information security and business continuity are also an extremely important element of our mission. To that end, we completely reviewed and updated our Information Systems Disaster Recovery Plans during 2005.

In our case, we really have two separate, but coordinated plans. One plan focuses on the recovery of the applications that manage member data and produce monthly payouts for all retired members and beneficiaries. This application (Legacy Pension System) runs at the Annapolis Data Center (ADC). We performed a joint test of the Disaster Recovery Planning with ADC in October. This test included actual relocation of ADC to their SunGuard recovery center in Philadelphia. Staff was able to follow the Disaster Recovery plan and demonstrate that we would be able to return to normal operations within 72 hours of a major disaster event at the Annapolis Data Center.

The second disaster recovery plan recovers the computing capability of our local computer center which is located at our primary site in Baltimore. This computer center provides connectivity to the Annapolis Data Center as well as provides all other computing used by the Agency. Local applications, office automation, internet, and email are among the many systems operated via this computer center. A test of this plan was also conducted in a conference room simulation of a disaster event and subsequent recovery. Computer System Disaster Recovery is an important element of our overall Business Continuity planning and we believe the Agency is adequately prepared.

Benefits Administration

Membership in the System grows every year. As has been the case in past years, the Agency saw an increase in the number of active members last year. More importantly, we saw a significant increase in the number of annuitants. In fiscal year 2005, the number of retirees and beneficiaries receiving benefits increased 5.6% - to over 100,000. Based on current numbers and projections, it appears that this trend will continue as the "baby-boomer" generation reaches the full retirement age of 62. Our current number of retirees and beneficiaries receiving monthly allowances is over 103,000.

One of the primary points of contact our members, retirees, and beneficiaries have with us is through our Interactive Voice Response (IVR) system. We recently completed a project to replace our old IVR system. This change was important to the Agency because our vendor could no longer support the maintenance of the old system.

In addition to all of the information that the old IVR system provided, the new IVR system provides additional account information to better serve our clients, including: where a retiree's check is being deposited, an itemized list of deductions from benefit payments, and detailed contribution and interest balances on member accounts. The new IVR system also offers us much greater flexibility to address the future needs of our clients. We have not overlooked the human factor as the caller always has the option of reaching a counselor. Phase one of the new system was successfully deployed in December.

Phase two of the new system will be the release of the TTY/TDD number for the IVR system. The old system was not ADA compliant. Testing is complete. Marketing the new number and deployment is expected in February.

The Agency conducted the 2005 Employees' Trustee election electronically for the first time. Members were able to vote via the internet or the interactive telephone response system.

Audit Division

With the assistance of an outside consultant, an agency-wide risk assessment was performed. The project's objectives were to promote a common language of risk and a better basis for on-going risk reporting and monitoring; develop a risk assessment process that enables the Agency to identify and provide

priority response to its mission critical risks; assess the Agency's risk management capability and develop recommendations for improvement and sustainability; provide a repeatable and practical risk assessment process with supporting tools and training; and provide recommended organizational options to help sustain an Agency-wide Risk Management process.

Not surprisingly, the overall results of the risk assessment identified our IT infrastructure and project execution (legacy modernization, disaster recovery and overall MPAS implementations) as the areas of highest risk. Our next highest risk categories were in Operations and Investment Management.

We have identified risk owners and developed improvement plans for the identified risks. Additionally, 50 staff members were trained on concepts and techniques for risk identification, assessment, analysis, prioritization and response.

An assessment of the Agency's internal control structure for benefits administration was conducted. It included assessing the controls for enrolling members, collecting membership and work history data, collecting member and employer contributions, and computing and paying retirement and disability benefits. The assessment, performed by Clifton Gunderson, LLP, did not identify any control weaknesses, i.e., any deficiencies that would prevent reasonable assurance that SRA can comply with regulations, operate efficiently, and prepare accurate financial statements. The report did, however, note opportunities for increased efficiency, primarily through increased automation and system interfaces which was expected.
A review of 10 Participating Governmental Units (PGU) was done to assess compliance with enrollment, payroll reporting, and contribution requirements. The review, performed by Lindsey & Associates, LLC, reported no specific deficiencies and showed general compliance with reporting requirements. A review of a second cohort of PGUs is underway and should be completed by late spring.

On behalf of the Board of Trustees and the State Retirement Agency staff, thank you for the opportunity to present this overview and we thank you for your continued support of our mission and efforts.

The Agency's responses to the Analyst's issues and specific requests for discussion follow.

Senate Budget & Taxation Committee

January 24, 2006

State Retirement Agency's Response to Legislative Analysis

Issue 1: Retirement Agency Continues Planning for New Procurement to Upgrade Its Information Technology System. The Board and staff are asked to present its plan for the design and development of MPAS including a detailed accounting of the system's total projected cost. This should include an estimate of the amount it expects to request for MPAS, either through deficiency appropriation or budget amendment, for fiscal 2007. SRA should also describe the project oversight mechanisms it has put in place to avoid past procurement mistakes. Furthermore, SRA should explain its rationale for a phased implementation of MPAS, and why it seeks to begin installing the system before it has developed a complete implementation plan.

Agency Response:

The Agency is following the State of Maryland Systems Development Life Cycle (SDLC) for the development of the Maryland Pension Administration System (MPAS). SRA has completed the Initiation and Systems Concept Development Phases of the SDLC. Upon completing the System Concept Development Phase the Agency committed to launching the first of several projects necessary to meet all of the objectives for MPAS, which it has named MPAS-1. The Agency is now in the Planning Phase to develop the MPAS-1 Project Plan and other planning documents.

A Request for Proposals has been released to obtain a Contractor to provide the MPAS-1 Project goods and services. These services include those required by the SDLC: requirements analysis, design, development, integration and testing, and implementation. SRA plans to award this contract in May 2006 and fully implement MPAS-1 by May 2008. Additional task orders using statewide contracts will also be released to provide additional project support services, including: IT security, quality assurance, project management, and independent verification and validation (IV&V).

The MPAS-1 Project has been divided into fifteen milestones, ten of which are directly related to recreating the existing capabilities of the Legacy Pension System (LPS). Breaking the project into these smaller milestones will enable the SRA Project Management Office (PMO) to regularly monitor the performance of the project team in meeting these specific targets, both in terms of schedule and budget. The project will also use a system development

methodology that treats each of the ten MPAS milestones as mini-systems and projects, each with its own development life cycle, schedule, and budget.

Each milestone will have its own requirements, design, development, testing, and implementation activities, assuring compliance with the SDLC. As each milestone is developed, SRA will test and use these products in parallel with the LPS to further validate and improve their performance. This "brick-upon-brick" approach should serve the Agency much better than other "big-bang" methodologies in which the entire system is developed and implemented as one whole. SRA is very aware of the risks associated with major IT development projects and has developed this approach to specifically make it more manageable.

When the success of MPAS-1 is assured, the Agency will launch the MPAS-2 Project, Improving Data Quality. SRA cannot fully automate the existing business processes without having full confidence in the quality of the MPAS data. Deficiencies in the LPS have led to a number of data issues that require a full audit of a member's service history prior to calculating their retirement benefit. Improving the data collection processes and MPAS would enable SRA to employ a much greater level of process automation, which would reduce errors and provide a better level of service to members. To achieve this objective, the MPAS-2 Project will:

- Improve the system controls used to validate the entry of data into MPAS;
- "Clean" the data that already exists within MPAS; and
- Improve the processes and systems used to collect payroll data from employers.

Upon completion of MPAS-1, SRA will consider other MPAS project investment alternatives based on their strategic value to the Agency. Plans and budgets for future MPAS projects will be developed as they are defined.

SRA has gathered data from many other state and local retirement systems on their technology project experiences. SRA has used this information to develop an initial project cost estimate for MPAS-1 of $11 million. This project cost estimate includes the cost for the development contract, supplemental service contracts, SRA project staff, and other direct and indirect costs. The Agency anticipates that the project cost will be distributed equally between Fiscal Years 2007 and 2008 ($5.5 million each year). SRA will revise these cost estimates as contracts for goods and services are

evaluated and awarded, and submit budget amendments accordingly. We will update committee and legislative staff as this information becomes available to us.

To ensure the success of the MPAS-1 Project SRA has implemented the following project oversight mechanisms:

1. The State Retirement and Pension System Board of Trustees authorize all major project policies, decisions, and actions. The Administrative Committee of the Board of Trustees is briefed on MPAS Project status and issues at each meeting and makes recommendations to the Board of Trustees on project decisions requiring Board action.
2. The Project Steering Team (PST) has been operating and meeting since December 2004. The PST membership includes the SRA Executive Director and other Agency senior management. The PST is responsible for project oversight and policy.
3. An MPAS Project Advisory Group (MPAG) was formed in December 2005 to provide independent guidance and advice on the MPAS Project. The MPAG members include senior technology leaders from the State government, public pension, and academic sectors.
4. The Department of Budget and Management, Office of Information Technology (OIT) provides oversight to all State agency major IT development projects. OIT performs project performance reviews either annually or at major project milestones. OIT has also created a peer review process that allows SRA agency peers an opportunity to provide guidance and advice to the Project.
5. The SRA Project Management Office (PMO) was created to ensure the successful implementation of MPAS. The PMO improves project performance by contributing proven project management professionals, policies, standards, methods, and tools.
6. The MPAS Integrated Project Team is the core project management team made up of managers from Administrative Division, Project Management Office, and Information Systems Division. These managers provide the day-to-day oversight and management of the project.

Other project management approaches SRA has implemented to ensure the success of the MPAS-1 Project are to:

- Strengthen business ownership and participation through business sponsorship and direct participation in project team

activities (e.g., requirements definition, design, prototype review, testing, etc.);

- Improve communications by developing a communications plan with accountability for implementation;
- Implement scope change control processes to ensure that project changes are analyzed and approved by a centralized SRA management team;
- Validate that system deliverables meet requirements by using proven software engineering methods, validating requirements traceability, and contracting for Independent Verification and Validation (IV&V) services;
- Enhance resource levels for the project by dedicating project managers and business staff to the project team;
- Reduce project risks by reducing the overall project scope, dividing the project into smaller segments to enable better status monitoring and more rapid course correction, and performing continuous risk analysis and management; and
- Strengthen testing processes by developing test scenarios as early as possible based on actual business scenarios and using proven methods and tools for managing the testing process.

The phased implementation of MPAS is an intentional strategy meant to directly remedy deficiencies identified in the Strategic Systems Development Project. Two problems from that effort are easily identified:

1. **The project scope was too large.** Information technology projects are inherently complex and challenging. There is certainly a direct relationship between project size and the degree of difficulty. The Strategic System Development Project attempted to achieve virtually every objective SRA had for technology supporting the pension administration business. This is far too ambitious. A key objective in developing the project approach for MPAS was to minimize the scope of the project.

2. **The project scope was too monolithic.** The completion of that project required that the entire system be successfully moved from concept, to requirements, to design, to development, to testing, and ultimately to implementation. It was very difficult for the Agency to ascertain in the early stages whether the whole of what was being defined and designed would actually meet the business needs. SRA has addressed this by breaking the MPAS-1 Project into fifteen milestones that allow us to incrementally define, design, build, test,

and implement MPAS. We intend to do this using an iterative
development style that allows SRA end users to see and touch
products very early in the design and development cycles. Each of the
individual products will be integrated into a whole as they are
developed and implemented.

The key to the SRA MPAS development approach is to reduce complexity
and risk by keeping the complete MPAS vision in discrete projects, breaking
these projects into discrete milestones, and implementing these milestones and
projects incrementally. Each milestone builds upon another. Each project
builds upon the last. One success breeds another.

SRA is fully aware of the importance of implementing a technology
foundation in the MPAS-1 Project that is robust and flexible enough to
support future MPAS projects. SRA believes that the technology
architectures available today have evolved to meet that challenge. A critical
requirement for private sector organizations is the ability to rapidly adapt their
technologies to support new business opportunities. Mainstream architectures
are designed to do so. SRA is seeking to select and implement these modern,
flexible technologies. While the SRA incremental approach will certainly
require some level of change and rework of prior efforts, we believe the
incremental approach is much more likely to be successful at SRA.

SRA has intentionally not published a comprehensive MPAS strategic plan to
reinforce this new MPAS philosophy of small and incremental. This
philosophy is now the mainstream in the private sector, as these "bottom line"
organizations seldom are willing to risk large investments on multi-year
initiatives that may never provide results due to the inherent risk associated
with large and complex projects. SRA believes that successful
implementation of early MPAS projects will ensure the support and success of
later MPAS efforts.

**Issue 2: As Teachers' Plans Fall Out of the Corridor, the Retirement
System Board Recommends Ending Corridor Funding Method. SRA is
asked to explain the rationale for recommending an end to the corridor
method.**

Agency Response:

Actuarial funding methods are set up to ensure proper funding of the normal
cost plus amortization of any gains and losses. Smoothing methods such as

asset smoothing are often used to reduce the volatility of contributions from year to year. However, smoothing methods can also result in contribution levels which lag changes in the system's true financial position. The corridor method is one of the latter smoothing methods - providing an additional layer of smoothing on top of those used in actuarial funding.

The use of actuarial funding results in higher contributions over the next several years than corridor funding, but under actuarial funding the funded ratio will not go as low as it would under corridor funding. This highlights the tradeoff between the timing of contributions and the ultimate trough in the funded ratio. That is, for a given level of contributions, earlier contributions would lead to a higher funded ratio, and this is the case with actuarial funding.

It is important to note that the analysis, which has the system achieving full actuarial value in about 25 years under both corridor funding and actuarial funding, assumes that all actuarial assumptions are fully realized. If these assumptions are not met, for example if investment returns fall below the 7.75% assumed return, then there will be actuarial losses which will be amortized, and will cause the system to be less than fully funded under either method. The use of the smoothing method will delay the increased contributions needed to compensate for the lower than expected investment return thereby exacerbating the decline in the funded ratio.

In discussing the alternatives, the Board discussed many issues including the appropriate funding level and the desired timeframe to achieve this funding level given resource constraints and competing initiatives at the State level. The Board agreed that it would be appropriate to 1) move toward the actuarial rate as a means to obtain full funding, (2) bring funding levels up, and (3) approach changes in a reasonable and pragmatic way.

Based on analysis and review of the various alternatives, the Board decided to recommend an immediate transition to actuarial funding. This recommendation would set the contribution level to at least the normal cost for each year that the plan is less than fully funded.

The Segal Group, who recently completed an independent actuarial audit of actuarial valuations for the Agency, also suggested that the corridor method should be modified to alleviate the risk it places on System funding and to avoid the potential shifting of required contributions to future generations.

Issue 3: Retirement Agency to Seek Independent Salary Setting Authority for 23 Positions, Including Most of Its Investment Division. SRA is asked to justify its request for an exemption from the State hiring cap and independent salary authority, and to present key findings from the compensation study it procured. SRA is also asked to estimate the cost of offering higher salaries for the 23 identified positions.

Agency Response:

Given the magnitude of investment assets and management expertise needed to administer a very complex system, the Board of Trustees has put a high priority on the agency's ability to attract and retain staff. The Board has contracted with McLagan Partners, to conduct a compensation study of positions. The McLagan Partners will provide data on the level of compensation of agency staff as compared to public funds and the private sector.

The agency expects the McLagan Partners report to be considered by the Board in February. At this point, without knowing the findings, it would be premature to put a cost associated with higher salaries for the identified positions.

The agency will update the committee on the report's findings in February.

Responses to Legislative Analyst's Recommended Actions:

1. **Delete 1.0 full-time equivalent that has been vacant for more than one year. The personal identification number of the position recommended for deletion is 005348.**

Oppose. The Agency requests that the position, Deputy Director of Benefits Processing be retained as part of its authorized positions.

This key managerial position was created in December 2003, to assist the Benefits Processing Director with the oversight and administration of a diverse staff consisting of 31 employees. This position serves as one of two managers responsible for the oversight and controls to ensure the validity and accuracy of benefit payments exceeding $1.6 billion annually. The complexity of the various benefit plans, the required pension and tax law knowledge and oversight of the division requires a Director and Deputy Director to manage the operation and supervise the staff.

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Strategic workforce planning is critical to position and prepare the Agency to address both the changes in the workforce and increased service demands. Deleting the position weakens the Agency overall by eliminating the Agency's ability to build depth into the management of the Benefits Processing Division, and its inability to provide for an orderly succession plan. Eligible for retirement, the Director has close to 34 years of State service. Losing the position places the Agency in jeopardy should the Director become ill or retire. The Agency's success is dependent on the leadership and management skills of its employees. It will require sufficiently skilled management to maintain service and quality levels as the Agency moves forward.

The Position is not vacant through lack of effort in recruiting for the position. The Agency has actively recruited four times.

1. The first recruitment effort began in January, 2005, and concluded at the end of February, 2005. A job offer was extended to an external candidate who declined the job due to the salary level. The second ranked candidate, an agency employee, accepted the position. In May, the incumbent applied and accepted a higher managerial position within the agency creating a new vacancy.

2. The second recruitment effort was conducted during August and September of 2005. Because the vacancy occurred during our peak processing period, the interview process was delayed. At the same time, the Agency experienced turnover in its HR staff that needed to initiate the recruitment process. Upon completion of the interviews, offers were made but the top candidates declined our offer due to salary considerations. The third ranked candidate was hired for a different Agency position.

3. The third recruitment effort concluded in November, 2005. This recruitment resulted in two additional candidates rejecting our job offer due to salary considerations.

4. The fourth recruitment effort, initiated in December, 2005, is ongoing. Seven eligible applicants applied. The interview panel is currently in the process of rating those interviewed.

The Agency requests the position be retained.

2. Delete 2.0 full-time equivalent new regular positions in the Administrative Division. These positions will be assigned either to the Benefits Processing Unit or the Data Control Unit. The Benefits Processing Unit, which calculates benefit estimates and processes benefit payments, has performed admirably with its current staff configuration. The Unit has processed 99.9% of retirement applications within its targeted timeframe and processed accurately 99.9% of benefits payments. It is difficult to imagine the unit improving on that performance. The number of new retirees each year whose applications must be processed has been relatively constant for the last five years, so DLS does not see any imminent increase in the unit's workload. The Data Control Unit, meanwhile, experienced a dramatic reduction in its workload in fiscal 2005. After converting 5.0 contractual FTEs to regular positions in fiscal 2006, further conversions are not warranted given the unit's reduced workload.

Oppose. Again, strategic workforce planning is critical to position and prepare the Agency to address both the changes in the workforce and increased service demands. The Agency's success is dependent on full-time positions to build a core group within the Agency not contractual positions that have higher turnover rates. The Agency requests conversion of two long-term contractual positions into permanent PINS. These are not new positions. The contractual Fiscal Account Technician II employee began employment with the Agency on January 8, 2001 while the contractual Administrative Specialist III employee has filled the position since January 24, 2000. Both individuals work in the Data Control Division under the Benefits Administrative Division.

1. Data Control Section - Employer Payroll Data Unit - Fiscal Account Technician II

This position receives, tracks, and processes all employer supplied pension payroll data received from over 130 participating employers in a variety of electronic media. As required by law, participating employers submit pension payroll data covering each pay period within 5 days of the pay date. Late filing may result in penalty and interest billings to the employer.

This employee tracks the participating employers' payroll schedules to identify submission dates of expected payroll data files and documents the

date of receipt of those files. Additionally, the employee processes the electronic media received to convert the data records for further automated Agency processing (edit validations). This position works with the Payroll Reconciliation team to ensure that the data records reconcile with the cash submitted by the employer and communicates with participating employers to resolve any issues related to the submission of this payroll data. Last fiscal year, the Fiscal Account Technician processed over 6,000 electronic payroll data files.

Workload demands necessitate contractual employees. Close to 43%, or 9 positions, working in this unit are contractual employees.   The long-term employment of this contractual position supports the Agency's request for conversion into a permanent position. Without the staffing position, the Agency must continue to employ contractually. The monitoring and conversion of member payroll data files cannot be eliminated.

2. Data Control Section – Membership Maintenance Unit – Administrative Specialist III

This position applies complex pension laws, regulations, standards and procedures in processing members' applications received to purchase additional service credit and/or military service credit. The job requires strong technical skills and knowledge of the pension law to determine eligibility and the applicable rules to calculate the number of eligible months and the cost to the member for the additional purchased service credit.

Three other positions perform similar duties. Last fiscal year, the unit manually processed almost 3,000 member requests to purchase additional pension service credit and an additional 1,000 applications for military service credit. Purchase and military service rules are complex and require time and experience to become technically proficient.

Converting this into a permanent position provides for the continued development and building upon the depth of knowledge needed to perform accurate purchase service cost calculations and determine military service credit members require in making retirement decisions and in some cases meet retirement eligibility.

The long-term employment of this contractual employee supports the Agency's request for contractual conversion into a permanent position.

Without the staffing position, the Agency must continue to fill the position contractually.

The Agency requests the two contractual conversions be retained.

3. **Delete funding for investment research. The Governor's allowance includes $100,000 for internal investment research studies in addition to $378,000 for investment consultants and a 0.5 FTE contractual position in the investment division. With additional staff and consultant support available to provide investment analyses, there is little need for internal research studies.**

Oppose. Research leads to innovation. It was the research done by staff with the aid of consultant that led to the changes in asset allocation which have improved performance. Investments are rapidly changing and it is vital to be able to perform the research needed to keep up with it.

Truly, what appears to be a minor decision makes a large difference in dollars. For example, we used Factset and MSCI Data to research what would be a better index fund for the System, the MSCI EAFE or the MSCI All World ex US. The research led to the MSCI All World ex US which led to hundreds of millions of additional dollars for the System.

The Agency requests that the $100,000 for investment research be retained.